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A DESCRIPTION OF THE MODIFICATION OF WISCONSIN'S USURY LAWS

CHAPTERS 45 AND 100, LAWS OF 1981

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Chapters 45 and 100 of the Laws of 1981 represent the most comprehensive single treatment of interest rate laws ever enacted by a Wisconsin legislature. Among other things, they replace the temporary rate limitations established by chapter 168, Laws of 1979. But unlike chapter 168, they apply to savings and loan associations and deal with a number of issues regarding real estate mortgage loans which were not addressed in chapter 168. This article is a section by section analysis of the provisions of chapters 45 and 100, which became effective November 1, and December 6, 1981, respectively.

I. THE GENERAL USURY STATUTE

A. *General Usury Statute, Sections 138.05(8)(c) and 138.06(8)*

Historically, section 138.05¹ formed a set of general rules applicable to all loans or forebearances, except those to corpo-

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The views expressed herein do not represent the official position of the Office of the Commissioner of Banking, State of Wisconsin.

1. WIS. STAT. § 138.05 (1977).

rations and those for which there were specific exceptions, such as the motor vehicle sales finance law. Section 138.05 no longer serves as the point of departure in the analysis of credit regulation. The application of the general usury statute was originally lifted by chapter 168 of the Laws of 1979. Chapter 45 of the Laws of 1981 continues this exemption. Under section 138.05(8)(c),² the rate limitations, delinquency charge provisions, rebate upon prepayment requirements, and the disclosure requirements of section 138.05 no longer apply to any type of loan or forbearance, with one exception.³ One can now assume that a loan or forbearance made in Wisconsin is unregulated unless it is covered by one of the remaining explicit statutes which deal with credit regulation. For all practical purposes, extensions of credit made for business purposes are not subject to any limitations under statutory law, unless secured by a first lien on the borrower's residence.

Section 138.06(8) simply exempts loans made after the effective date of chapter 45 from the penalty provisions of the general usury statute. There are separate penalty provisions in chapter 45 which apply to loans made on or after November 1, 1981.

II. FIXED-RATE, FIXED-TERM RESIDENTIAL REAL ESTATE MORTGAGE LOANS

A. *Residential Mortgage Loans, Section 138.052*

Sections 138.052 and 138.056, along with chapter 428,⁴ comprise the entire regulatory structure for residential real estate mortgage lending in Wisconsin. The two new provisions in chapter 138 replace sections 138.05, 138.053 and 138.055. These sections apply to new loans as well as any residential real estate loan which is refinanced, renewed, extended or modified on or after November 1, 1981.

2. WIS. STAT. ANN. § 138.05(8)(c) (West Supp. 1982). All references to statutory sections are to the 1982 Supplement to Wisconsin Statutes Annotated unless otherwise noted.

3. Open accounts for personal, family or household purposes on which the merchant assesses only a late charge or penalty for nonpayment when due remain covered by § 138.05.

4. Chapter 428 is limited in its application to covered loans where the amount financed is \$25,000 or less. § 428.101.

B. Definitions, Section 138.052(1)

A residential mortgage loan is one secured by a first lien real estate mortgage on, or equivalent security interest⁵ in, a one to four family dwelling which the borrower uses as his principal residence.⁶ This definition includes residential real estate loans made by a savings and loan association. As a result, all lenders are covered by legislation involving these loans for the first time since April 6, 1980, when the savings and loan industry was excluded from the provisions of sections 138.05 and 138.051 by chapter 168 of the Laws of 1979. However, section 138.052 does not apply to a mobile home transaction. Those transactions are defined in section 138.056(1)(c) to include any consumer credit sale or consumer loan secured by a first lien or equivalent security interest in a mobile home.⁷ Moreover, by definition, this section would not apply to a second mortgage loan.⁸ Such a transaction, if made for personal, family or household purposes would be covered by the Wisconsin Consumer Act if the amount financed is \$25,000 or less.⁹ Otherwise second mortgage transactions are unregulated.

"Contract rate" is defined as the rate contracted to be paid from time to time on the principal of a loan.¹⁰ Although there is no limitation on that rate, the definition is important because it contemplates a rate of interest which may change from time to time. It also describes the rate to be applied when determining unearned interest for purposes of rebate upon prepayment, and to be applied after acceleration or maturity.¹¹ The term "loan administration" is defined as activities undertaken by the lender to review, underwrite and eval-

5. A second mortgage held by the holder of the first mortgage is considered an equivalent security interest for purposes of the Wisconsin Consumer Act (WCA). 63 Op. Att'y Gen. 557 (1974); WIS. ADMIN. CODE § BKG. 80.261 (1980). Since the language in § 138.052 is identical to that in the WCA, the same interpretation is likely to apply in § 138.052.

6. § 138.052(1)(b).

7. "Mobile home" is defined in WIS. STAT. § 218.10(2) (1979).

8. The definition of "loan" applies only to first lien or equivalent real estate secured mortgage loans. § 138.052.

9. WIS. STAT. §§ 421.301(17), 421.202(6) (1979).

10. § 138.052(1)(a).

11. Variable rate transactions are discussed *infra*, § III. This section deals only with fixed-rate mortgages.

uate the application, document preparation and administration of the loan closing. The definition excludes activities such as surveys which are normally performed by third parties.¹²

C. Prepayment Penalties, Sections 138.052(2)-(4)

Section 138.052(2)(a) begins with the proposition that a borrower may repay a fixed-rate, fixed-term residential mortgage loan in whole or in part at any time. However, if a prepayment occurs within five years of the date of the loan, the lender may assess a penalty. That penalty equals sixty days' interest at the contract rate applied to the dollar amount by which the aggregate principal prepayments in a twelve month period exceed 20% of the original amount of the loan.¹³ The provision is not intended to permit the lender to repeatedly aggregate payments for the purpose of calculating this penalty. For example, if the borrower prepaid 25% of the principal amount of the loan during one month, the aggregate principal prepayments for the next twelve months, at least, would exceed 20% of the original amount of the loan. However, the lender is not entitled to a prepayment penalty in each of the twelve succeeding months.

The lender may not assess a prepayment penalty if prepayment occurs more than five years from the date of the original loan.¹⁴ This restriction applies even though the loan is refinanced, renewed, extended or modified during this five year period.¹⁵ For example, if the original loan note has a maturity of three years and the balloon payment is refinanced at the end of that period for an additional three years, the bor-

12. § 138.052(1)(c).

13. § 138.052(2)(a)(2). A simple example illustrates the penalty calculation.

Assume: - \$60,000 - amount financed

- 16.50% - interest rate

- 30 year - scheduled amortization period; monthly payments

- prepayment after 4 years (48 monthly payments)

Outstanding balance after 4 years = \$59,592

[\$60,000 - (1-.9932)(\$60,000)]

Penalty = $60/365 \times 16.50\% \times (\$59,592 - \$12,000)$

[\$12,000 = 20%(\$60,000)]

= \$1,290.85

14. § 138.052(2)(a)(3).

15. *Id.*

rower may not be assessed a prepayment penalty if the loan is prepaid five or more years from the date of the original note. A new five year period does not begin to run with each revision of a covered real estate mortgage loan.

1. Rebate Upon Prepayment, Section 138.052(2)(b)

Section 138.052(2)(b) is founded upon the principle that whenever a borrower prepays a fixed-rate, fixed-term real estate mortgage loan, that borrower is entitled to a refund of any unearned interest which the borrower has paid. This requirement applies when the loan is prepaid by cash or whenever it is renewed or refinanced.

Initially, the lender must determine whether the customer is entitled to a rebate of any prepaid charges. The lender deducts from the total prepaid charges any prepaid charges which are earned in full as of the closing, according to the terms of section 138.052(3), such as certain fees paid to third parties or a loan administration fee of not more than 2% of the principal amount of the loan.¹⁶ The lender then multiplies any remainder by a fraction, the numerator of which is the number of unexpired (remaining) payment periods and the denominator of which is the total number of installments in the amortization period.¹⁷ An installment period is unexpired if prepayment occurs within fifteen days of the payment's due date. The result is the unearned prepaid charges which are rebatable to the borrower. In other words, prepaid charges subject to rebate are earned on a pro-rata basis.

In calculating the rebate of the remaining unearned interest charge, the lender may select one of two alternatives. First, the lender may determine whether the borrower has paid any portion of the interest which is allocable to all unexpired payment periods.¹⁸ A payment period is considered unexpired if prepayment occurs within fifteen days following the payment's scheduled due date. In other words, if the borrower prepays within fifteen days of a scheduled payment due date, that period is considered unexpired for purposes of calculating

16. The language in the subsection is unclear as to whether it permits exclusion from the finance charge of a loan administration fee of 2% of the loan where actual incurred loan administration expenses are less than 2% of the loan amount.

17. 1981 Wis. Laws ch. 100, § 1 (to be codified at Wis. Stat. § 138.052(2)(b)).

18. § 138.052(2)(b)(1).

unearned interest subject to rebate. Unearned interest is the total interest which would be earned for each unexpired payment period if the contract rate on the date of prepayment is applied to the unpaid principal balance for each of these unexpired payment periods. This calculation is made based on the assumption that each payment is made as scheduled. In making this calculation, the lender may decrease the contract rate to the next multiple of 0.25%.

The second method of determining the unearned interest is simply to deduct from the total interest charge all prepaid interest and the amount determined by applying the contract rate, according to the actuarial method,¹⁹ to the unpaid balances of principal for the actual time those balances were unpaid.²⁰ Since the principal balance will include any additional charges which are not earned in full, application of the contract rate to the principal balance for the time the balances were unpaid will determine the interest earned on those charges.

As noted above, the statute excludes a number of prepaid charges from the definition of interest for purposes of computing a rebate of unearned interest. The following charges are excludable from interest and, therefore, entirely earned by the lender at the time the loan is closed.

1. Separately itemized and bona fide charges paid to third parties for services incident to the loan.²¹ These would include such things as surveys, credit reports, appraisals, title opinions and title insurance.
2. Servicing fees or discounts imposed by secondary mortgage market purchasers such as the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation or any other private secondary mortgage market

19. The term "actuarial method" is defined in WIS. ADMIN. CODE § BKG. 80.221 (1981). In the Code, the definition is explicitly made applicable to "consumer credit transactions." The typical residential mortgage is a "consumer credit transaction" as defined in WIS. STAT. § 421.301(10) (1979) even though the Wisconsin Consumer Act specifically excludes such transactions from its purview. WIS. STAT. § 421.202(6), (7) (1979). Accordingly, the definition of "actuarial method" advanced by the Commissioner of Banking is presumably applicable, at least insofar as lenders are subject to the jurisdiction of that office.

20. 1981 Wis. Laws, ch. 100, § 1 (to be codified at WIS. STAT. § 138.052(2)(b)(2)).

21. § 138.052(3)(a).

purchaser not related to the original lender.²² Specifically, this would include the $\frac{3}{8}$ point servicing fee which a financial institution would pay to sell its loan to a government-sponsored secondary mortgage market purchaser. This exclusion apparently applies even though the lender selling the loan is the servicer²³ and would, therefore, recover this fee in its entirety.

3. Loan administration fees, including fees paid to third parties for loan administration services²⁴ not to exceed 2% of the loan amount would be subject to rebate in the event of prepayment. Loan administration fees in excess of 2% may, however, be excludable from interest for rebate purposes under other provisions of this section.²⁵ Loan administration includes such things as the preparation of escrow agreements for taxes and insurance, as well as any documents necessary to close the loan in escrow.

4. The prepayment penalty permitted by section 138.052(2)(a)(2).²⁶

5. Loan commitment fees.²⁷

6. Amounts paid to the lender by any person other than the borrower.²⁸ This exemption is aimed specifically at excluding seller's points from the interest charge. This exclusion was included, in part, due to the difficulty of separating seller's points from the actual cash price of the underlying property.

Section 138.052(4) provides that in calculating the rate of interest under subsection (2)(b), the parties may agree that any installment paid within thirty days prior to or after the scheduled due date is paid on the due date.

D. Interest on Escrow, Sections 138.052(5) and 138.051(5)

Section 138.052(5) brings savings and loan associations and mortgage bankers within the requirement that financial insti-

22. § 138.052(3)(b).

23. That is, the seller continues to receive and process payments from the borrower.

24. The clause excluding fees paid to third parties for loan administration services is confusing in that the definition of "loan administration" explicitly does not include "activities . . . normally . . . performed by 3rd persons." § 138.052(1)(c). It is unlikely that a substantive distinction was intended by use of the word "parties" in § 138.052(3)(c) and use of "persons" in § 138.052(1)(c).

25. § 138.052(3)(c).

26. § 138.052(3)(d).

27. § 138.052(3)(e).

28. § 138.052(3)(f).

tutions pay interest on required escrow accounts established to assure payment of taxes or insurance. Under subsection (5)(a), interest at a rate of at least 5.25% per year must be paid on any escrow balance which the lender requires the customer to maintain for taxes or insurance.²⁹ The provision applies only to loans originated after January 31, 1983.³⁰ However, if the lender places the escrow funds with a third party in a noninterest-bearing account, the lender need not pay interest on the escrow balance. Given this exemption, a mortgage lender may be able to establish a noninterest-bearing account with a subsidiary corporation and avoid the interest payments to its borrowers even though the subsidiary itself invests or otherwise places these funds in an interest-bearing account and receives the benefits of the interest.

Payment of interest on escrow accounts may also be waived by agreement if more than 75% of the lender's interest in the loan is sold to a third party not related to the lender and the escrow funds are held by the third party.³¹ For example, if the lender sells more than 75% of the loan to an unrelated third party which holds the escrow funds, the lender need not pay interest on the escrow balance even though it continues to service the loan. This section assumes that a third party purchaser of a mortgage loan in the secondary market would not hold escrow funds for taxes or insurance if the originating lender remained the servicer under the purchase contract.

Section 138.051(5) continues the requirement originally created in chapter 168 of the Laws of 1979, that banks, credit unions and mutual savings banks which require tax or insurance escrows must pay interest on the principal balance of the escrow account at a rate of at least 5.25% per year. This requirement applies not only to loans originated after the effective date of the act, November 1, 1981, but to any renewal,

29. No particular method for calculating such interest is specified.

30. Note that this provision applies to loans "originated" after Jan. 13, 1983. § 138.052(5)(a). Loans include those "made, refinanced, renewed, extended or modified" § 138.052(1)(b). Thus, it is not at all clear that interest is required on escrows for loans by savings and loan associations or by mortgage bankers which are refinancings, renewals, extensions or modifications. Such loans would, however, require interest on escrows if given by banks, credit unions or mutual savings banks. § 138.051(5).

31. § 138.052(5)(b).

extension or modification following the act's effective date. Section 138.052(5), as noted above, seemingly does not apply to loans by savings and loan associations or mortgage bankers, except as to originations after January 31, 1983.

E. Delinquency Charges, Section 138.052(6)

In real estate mortgage loans subject to section 138.052(6), a delinquency charge is limited to 5% of the unpaid amount of any installment not paid on or before the fifteenth day after its due date. For purposes of determining whether a delinquency charge is assessable, payments are applied first to current installments and then to delinquent installments. A delinquency charge can be assessed only once on any installment. In general, the calculation of delinquency charges under this section is the same as that provided under the Wisconsin Consumer Act³² in section 422.203. Therefore, if a customer misses one payment and then makes full payment on each succeeding installment on a timely basis, only a single delinquency charge may be assessed on the installment which was missed. The lender may not attribute each payment to delinquent installments first and, thereby, assess a delinquency charge on each succeeding installment (which would then be overdue as the payment was attributed to the delinquent installment) until the customer brings the entire loan balance current.

F. Interest after Maturity, Section 138.052(7)

Section 138.052(7) limits the rate of interest imposed on the balance outstanding after acceleration or maturity to the contract rate. It is unclear under this section what rate applies after maturity if the contract rate is subject to change under section 138.056.³³

G. Federally Insured Loans, Section 138.052(8)

Section 138.052(8) provides that loans which are insured or guaranteed by the Secretary of Housing and Urban Development, or are under Farmers Home Administration or Veterans

32. WIS. STAT. §§ 421-427 (1979).

33. Is there anything, for example, to prevent post-maturity increases in loans subject to § 138.056(2)(c), commonly called mortgages with "escalator clauses"?

Administration loan programs are not subject to the requirements of section 138.052.

H. Wisconsin Consumer Act and Chapter 428 Exclusions, Section 138.052(9)

Section 138.052(9) provides that if the principal balance of a residential mortgage loan was originally in excess of \$25,000, any subsequent refinancing, modification, extension, renewal or assumption of that loan is not covered by the Wisconsin Consumer Act or chapter 428 even though the unpaid principal balance at the time of this subsequent event is \$25,000 or less. Consequently, if, for example, the unpaid balance of a real estate mortgage loan originally in the amount of \$60,000 is \$20,000 at the time it is refinanced, the lender need not use loan forms which comply with the Wisconsin Consumer Act or chapter 428 to evidence that extension. Similarly, the borrower does not acquire the protections of either of these statutes as a result of subsequent refinancings of these loans. In summary, once the loan is covered by section 138.052, it can never be covered by the Wisconsin Consumer Act³⁴ or chapter 428.

I. Miscellaneous Exclusions, Sections 138.052(10), (11) and 138.051(8)

Sections 138.052(10), (11) and 138.051(8) provide that section 138.052 does not apply to loans to corporations and that the contract rate of residential real estate mortgage loans is not subject to the rate limitations imposed under this chapter or sections 218.01 or 422.201. These sections seem to be largely superfluous. Unless the term "borrower" includes a guarantor or similar party, a residential real estate mortgage loan, by definition, could not be made to a corporation. Moreover, since the definition of "loan" excludes mobile home transactions from the applicability of section 138.052, there is no possibility that the contract rate of a real estate mortgage loan could be subject to section 218.01. In addition, real estate mortgage loans are excluded from the Wisconsin Consumer

34. The one exception to this stricture is where both parties agree to be subject to the Consumer Act, as contemplated in Wis. STAT. § 421.301(17) (1979).

Act either by virtue of the fact that they involve more than \$25,000 or that they are covered by chapter 428.³⁵

Section 138.051(8) provides that the contract rate in transactions covered by section 138.051 is not subject to any rate limitation imposed under this chapter or under sections 218.01 or 422.201. This section also appears to be superfluous since section 138.051 only applies to residential real estate mortgage loans, made on or after April 6, 1980 and prior to November 1, 1981.³⁶ These loans are not subject to the rate limitation in section 138.05 because of the exemption in section 138.05(8).³⁷ Lastly, the interest rate limitations of the Wisconsin Consumer Act, section 422.201, would not apply to a first lien or equivalent residential real estate mortgage loan because they are exempt from the Wisconsin Consumer Act by virtue of chapter 428.³⁸

J. Penalties, Section 138.052(12)

Section 138.052(12) provides that if a lender violates subsections (2)(b), (5), (6) or (7), the lender is liable for actual damages, costs, reasonable attorney fees, and a penalty of \$500. However, the lender may avoid liability if the error was unintentional and was corrected by the lender upon demand. The provisions subject to penalty include failure to rebate correctly upon prepayment, failure to pay interest on escrow, assessing an excessive delinquency charge, or imposing interest after maturity at a rate higher than the contract rate. Interestingly, however, it is not a violation of this section to simply assess a prepayment penalty greater than that permitted by section 138.052(2). Presumably, a court or regulator could consider that practice a failure to rebate in accordance with subsection (2)(b) by excluding from unearned interest an amount greater than that permitted by subsection (3)(d). A lender would not be able to earn a portion of an excessive prepayment penalty under section 138.052(2)(b) because such a

35. WIS. STAT. § 421.202(6), (7) (1979). Note, however, that loans for commercial or agricultural purposes, which would otherwise not be subject to §§ 138.052 and 138.056, can become subject to these sections if secured by a first lien or equivalent real estate mortgage on the borrower's residence, unless the borrowing entity is a corporation.

36. WIS. STAT. § 138.051(1)(b) (1979).

37. See *supra* note 3.

38. WIS. STAT. §§ 428.101, 421.202(7) (1979).

penalty is not a "prepaid charge" covered by the introductory portion of that subsection. The excess charge would simply constitute interest assessed in a manner inconsistent with either of the methods approved in subsections 138.052(2)(b)(1) and (2).

III. VARIABLE RATE RESIDENTIAL REAL ESTATE MORTGAGE LOANS

A. *Variable Rate Loans, Section 138.056*

Section 138.056 replaces sections 138.053 and 138.055. It is intended to provide a vehicle to enable financial institutions in Wisconsin to make variable rate real estate loans, subject to some protections for borrowers. A variable rate loan includes either a residential mortgage loan as defined in section 138.052 or a mobile home transaction, either of which permit the interest rate to be increased or decreased.³⁹ A mobile home transaction includes a consumer credit sale or a consumer loan which is secured by a first lien or equivalent security interest in a mobile home.⁴⁰ Thus, while a variable rate residential mortgage loan may be subject to both sections 138.052 and 138.056, a variable rate mobile home transaction will be subject only to the latter section.

A variable rate loan includes any loan in which the borrower agrees that the lender can increase or decrease the interest rate⁴¹ from time to time. Such a provision is generally known as an "escalator clause," where the lender may unilaterally change the rate. A variable rate loan also includes one in which the rate of interest may fluctuate as the result of a change in an index rate selected by the lender. However, if the lender selects this option, the statute provides that the index must be an "approved index" as defined in section 138.056(1)(a). An approved index includes any of the following:

1. The national average mortgage contract rate computed by the Federal Home Loan Bank Board;

39. § 138.056(1)(d).

40. § 138.056(1)(c).

41. Note that the term "interest rate" is used in § 138.056 while the term "contract rate" is used in § 138.052. It is not clear what, if any, import attaches to this distinction.

2. The monthly average of weekly auction rates on three-month or six-month United States treasury bills;
3. The monthly constant maturity yield on one, two, three or five year United States treasury securities; or
4. An index which is readily verifiable by the borrower and beyond the control of the lender and which is approved by either the Commissioner of Savings and Loan, the Commissioner of Credit Unions, the Commissioner of Insurance, or the Commissioner of Banking. The Commissioner of Banking may approve indices for banks as well as for lenders other than those regulated by a named Commissioner. [The Commissioner of Banking has approved an annual average of the 12 monthly yields on 3 year United States government securities adjusted to a constant maturity as an index.]⁴²

This section also contains a definition of "dwelling" which covers a cooperative housing unit and a mobile home.⁴³ However, the reference therein to a mobile home is superfluous since a "variable rate loan"⁴⁴ includes a mobile home transaction⁴⁵ which, itself, refers to the definition of a mobile home contained in section 218.10(2).⁴⁶ Moreover, assuming the definition is necessary, it should have been placed in section 138.052, where the definition of "loan" refers to a "dwelling."

B. General Restrictions, Section 138.056(2)

Under section 138.056(2)(a), a variable rate loan contract may not provide for a term of more than 40 years.⁴⁷ Subsection (2)(b) provides that if the rate is to be adjusted according to an index, the lender must use an approved index. The index value used must be the most recently available value for that index prior to the date on which the loan is closed.⁴⁸

42. Letter from the Office of the Comm'r of Banking to Banco Mortgage Co. (Nov. 27, 1981).

43. § 138.056(1)(b).

44. § 138.056(1)(d).

45. § 138.056(1)(c).

46. WIS. STAT. § 218.10(2) (1979).

47. As this article was prepared for publication, a proposal was pending to extend the maximum permissible maturity for mortgage loans by state chartered savings and loan associations from 30 years (WIS. ADMIN. CODE § S-L 18.07 (1979)) to 40 years to conform with ch. 45. Clearinghouse Rule 81-202.

48. No relationship is mandated between the initial index value and the initial interest rate.

Whenever the interest rate is adjusted according to the index, that adjustment must reflect the difference between the initial index value and the value for that index which was most recently available as of the date notice of the interest rate adjustment is mailed to the borrower.⁴⁹ If the index rate declines, the contract rate must be decreased to reflect that shift except to the extent the decrease is offset by increases in the index which the lender did not reflect as increases in the contract rate. A lender may, at the time the interest rate is contractually authorized to be increased, forego an authorized upward adjustment in the rate. If the lender does so, that increase amount may be carried forward and applied at any succeeding interest rate adjustment date, provided the increase is not offset by a subsequent decrease in the index. If the variable rate loan contract provides that the interest rate will change according to some minimum percentage increment, that increment must apply to both increases and decreases. Similarly, if the contract limits the percentage to which the interest rate may decrease, interest rate increases must be restricted to the same extent.

Section 138.056(2)(c) provides that if the interest rate does not vary according to an approved index, the lender may not increase the interest rate by more than 1% during any six month period. However, if an increase is waived, the lender may subsequently increase the interest rate to that rate which incorporates each authorized increase as if all increases had been made at the first opportunity.

C. Prepayment Penalties, Section 138.056(3)

Section 138.056(3)(a) provides that a variable rate loan using an approved index as well as any mobile home transaction covered by this section may be prepaid at any time in whole or part without penalty. No penalty, such as that described in section 138.052(2)(a), may be assessed. Other variable rate loans, such as those using escalator clauses, may be prepaid in whole or in part without penalty within thirty days after notice of any increase in the interest rate. However, if such a

49. The manner in which the interest rate adjustment "reflects" the index variation is not restricted; i.e., a one percentage point change in the index may, but need not, be reflected by a one percentage point change in the interest rate.

loan is prepaid before or after the termination of such a thirty day period, the lender may contract for the prepayment penalty described in section 138.052(2)(a)⁵⁰ if the loan is prepaid within five years of its origination date.

A lender may not assess a fee in connection with the adjustment of the interest rate or for costs associated with adjusting the payments, the principal balance or the term of the loan in order to implement an interest rate adjustment.⁵¹

D. Notice of Interest Payment Changes, Section 138.056(4)

Section 138.056(4) requires that a lender must provide a borrower with notice of a change in the interest rate. The lender must provide notice within thirty days⁵² of any change which would increase the borrower's periodic payments, other than by an adjustment to the final payment. If, however, the change is to be implemented either by an adjustment to the final payment or by an adjustment to the term of the loan, the lender need only provide notice no later than fifteen days after the proposed change.⁵³ The notice must be mailed to the borrower's last known address and contain the date on which the interest rate will change, the amount of change between the new rate and the old rate, a description of the changes in the index which caused the adjustment, and the dollar amount of the monthly principal and interest payments required to implement the change.⁵⁴ The notice must also describe any prepayment rights of the borrower.

E. Negative Amortization, Section 138.056(5)

A lender may increase the interest rate in accordance with section 138.056 without making a related increase in the borrower's monthly payment. In certain situations, the borrower's payment may not cover all of the interest earned during each payment interval. If that situation occurs, the principal balance can be increased each month by the difference between

50. See *supra* § I, C.

51. § 138.056(3)(b).

52. By virtue of the use of the phrase "within 30 days," a notice given one day before the change would presumably comply with the statute, if read literally.

53. § 138.056(4)(a).

54. § 138.056(4)(b).

the earned interest and the borrower's payment. This phenomenon is called negative amortization. If this occurs within the first ten years of the loan or during any succeeding five year period, section 138.056(5) provides that the lender must, at the conclusion of each of those periods adjust the payment to a level which would amortize the loan at the current interest rate⁵⁵ over its remaining term. One purpose of this subsection is to prevent situations in which the lender and borrower ignore the effect of successive rate increases to the point where either the borrower cannot afford the payments when the increases are finally reflected in the payments or where the loan balance reaches such a level that an unfavorable loan-to-value ratio⁵⁶ is attained.

F. Disclosures, Section 138.056(6)

Section 138.056(6) requires that a lender make certain disclosures to the borrower in connection with any variable rate loan. Such disclosures must be given before making the loan. The lender must disclose that the loan contract contains a variable interest rate provision.⁵⁷ The disclosures must identify any approved index and the initial index value.⁵⁸ The lender must describe the borrower's right to prepay in connection with any notice of a change in the interest rate and that the lender must provide a notice of any intended interest rate increase.⁵⁹

G. Miscellaneous Provisions, Sections 138.056(7) and (8)

Section 138.056(7) provides that any increase in the principal balance as a result of negative amortization is subject to the same priority under the mortgage securing the loan as the original loan proceeds. Subsection (8) provides that section 138.056 does not apply to loans or forebearances to corporations and applies only to transactions entered into on or after

55. Presumably, such amortization would be calculated assuming no future interest rate adjustments.

56. State law presently provides restrictions on such ratios. See, e.g., WIS. ADMIN. CODE § S-L 18.05 (1979), where the lender is a state chartered savings and loan association.

57. § 138.056(6)(a).

58. § 138.056(6)(b).

59. § 138.056(6)(c), (d).

November 1, 1981. The reference to corporate loans is superfluous since, under the exemption applicable to transactions covered by section 138.052, covered loans could not be made to a corporation.⁶⁰

*H. Exemptions for Escalator Clause and Indexed Loans,
Sections 138.053 and 138.055*

Sections 138.053 and 138.055 have been amended to provide that they do not apply to loans made after November 1, 1981. These sections formerly regulated loans with escalator clauses and indexed variable rate loans respectively. However, the creation of section 138.056 covers both types of loans and, therefore, continued applicability of these sections is unnecessary.

IV. LICENSED LOAN COMPANIES

Chapter 45 of the Laws of 1981 contains a number of amendments which affect licensed loan companies. The amendment to section 138.09(3)(e) is intended to provide licensed loan companies with the ability to make certain types of loans which are subject to no greater regulation than that applicable to other types of lenders. The amendment provides that a licensed loan company can make loans for business or agricultural purposes, loans in which the principal amount exceeds \$25,000, and first lien real estate mortgage loans under sections 138.051 to 138.06. Those loans, as well as any motor vehicle sales finance activity under section 218.01, are not subject to section 138.09. Therefore, a licensed loan company can make a business loan or a loan for personal, family, household or agricultural purposes exceeding \$25,000 and that loan is not subject to *any* statutory restrictions. If a licensed loan company makes an agricultural loan under \$25,000, it will be covered by the Wisconsin Consumer Act⁶¹ but not section 138.09. Similarly, if the lender makes a residential real estate mortgage loan, it will be covered by sections 138.052 and 138.056; however, it will not be covered by section 138.09.

60. § 138.052(10).

61. Such a loan is not, however, subject to restrictions on interest rates. § 422.201(12).

A. *Rate Limitations, Section 138.09(7)(bn)*

Section 138.09(7)(bn) provides new rate limitations for licensed loan companies. As in the past, there is a higher rate structure for loans below \$3,000 compared with loans of \$3,000 or more. In each category, there is a basic ceiling as well as floating limits based on two indices. The lender may select the result which will yield the highest rate.

On loans of \$3,000 or less, the basic ceiling is 23% per year.⁶² On loans of \$3,000 or more, the basic ceiling is 21% per year.⁶³ Alternatively, in either category, the lender may charge up to a rate of either six percentage points in excess of the interest rate applicable to two year United States treasury notes or a rate of six percentage points in excess of the interest rate applicable to six month United States treasury bills.⁶⁴

The floating ceiling obtained from two year United States treasury notes changes quarterly. The limit during any calendar quarter is the average annual rate reported at the last auction of these notes in the preceding calendar quarter plus six percentage points, increased to the next multiple of 0.5% if a fractional amount is involved.⁶⁵ Since two year treasury notes are auctioned once each month, the auctions in March, June, September and December will determine this indexed ceiling for each subsequent calendar quarter.

The interest rate ceiling derived from six month United States treasury bills changes monthly. It is the average discount interest rate determined by the last auction of these bills in the preceding month increased to the next multiple of 0.5%.⁶⁶ Six month treasury bills are auctioned every Monday unless that Monday is a federal holiday. The auction rates for six month treasury bills and two year treasury notes are reported in the *Wall Street Journal* and many large newspapers. The Commissioner of Banking is to make available information regarding changes in these indices.⁶⁷

62. § 138.09(7)(bn)(1)(a).

63. § 138.09(7)(bn)(2)(a).

64. § 138.09(7)(bn)(1)(b), (c), (2)(b), (c).

65. § 138.09(7)(bn)(3)(a). Thus, for example, an auction rate of 15.13% at the last auction in June would yield a ceiling of 21.5% for the July-September quarter. Compare § 138.052(2)(b)(1) relative to fractional rates.

66. § 138.09(7)(bn)(3)(b).

67. § 138.09(7)(bn)(4).

B. Rebate for Prepayment, Section 138.09(7)(gm)

For six months after the effective date of chapter 45, a licensed lender may continue to use the Rule of 78⁶⁸ as a method of calculating the rebate of unearned interest upon payment.⁶⁹ However, beginning with transactions entered into on May 1, 1982, licensed loan companies will no longer be able to apply the Rule of 78 to consumer transactions which have a term of forty-nine months or more.⁷⁰ On shorter term transactions, licensed loan companies may continue to use the rebate method described in section 422.209(2)(a), i.e., the Rule of 78, in any transaction which is repayable in substantially equal installments at approximately equal intervals.⁷¹ The lender will retain the ability to consider additional interest assessed during an initial installment period which is greater than one month as earned if prepayment occurs after the first installment due date.⁷² For short term loans with irregular payment periods, unearned interest is the difference between the interest charged and the interest earned at the annual percentage rate computed upon the unpaid principal balance.⁷³

On longer term loans, the lender must use the rebate formula described in newly created section 422.209(2)(b). Again, the lender may retain additional interest arising from an extended first installment period. That rebate formula is described further in section VII of this article.

These restrictions will not apply to loans for commercial purposes because section 138.09(3)(e) provides that a licensed lender may engage in the business of making loans for business purposes which are not subject to the precomputed loan law.

68. See *infra* § VII, I.

69. 1981 Wis. Laws ch. 45, § 52.

70. § 138.09(7)(gm)(2).

71. § 138.09(7)(gm)(1)(a).

72. § 138.09(7)(gm)(1)(c).

73. § 138.09(7)(gm)(1)(b). However, since consumer loans made by licensed lenders are subject to the balloon payment restrictions in § 422.202, licensed lenders seldom make consumer loans with irregular repayment schedules to which this rebate formula would apply.

V. INSURANCE PREMIUM FINANCE COMPANIES

Chapter 45 amends several sections of the Wisconsin Insurance Premium Finance Law.⁷⁴

A. *Maximum Rate Limitations, Section 138.12(9)*

Amendments to section 138.12(9) provide that if the premium finance agreement evidences a transaction for personal, family or household purposes, the rate of finance charge may not exceed that permitted under section 422.201(2)(bm) for closed-end consumer credit.⁷⁵ However, the creditor is also entitled to an additional charge of \$10 if the principal balance is more than \$100, or \$6 if the principal balance is between \$50 and \$100. Alternatively, if the transaction is for commercial or agricultural purposes, there is no limitation on the rate of the finance charge.

B. *Delinquency Charges, Section 138.12(11)*

The \$5 limitation on delinquency charges has been deleted in section 138.12(11). The delinquency charge limit is the greater of \$1 or 5% of the delinquent installment. In addition, the maximum cancellation charge has been increased from \$5 to \$15.

VI. MOTOR VEHICLE SALE FINANCE COMPANIES

A. *Maximum Rate Limitations, Section 218.01(6)*

Section 218.01(6)(bn)(1) provides that the maximum rate on the retail installment sale of a new or used motor vehicle may not exceed the maximum rate permitted in section 422.201(2)(bm)⁷⁶ for closed-end credit if the transaction is a consumer transaction.⁷⁷ However, with respect to a retail installment sale which is not a consumer transaction,⁷⁸ there is no longer a maximum rate limitation.⁷⁹ Moreover, a retail installment sale of a mobile home is not subject to any rate limi-

74. WIS. STAT. § 138.12 (1979).

75. § 138.12(9)(b), (bn). See *infra* § VII, A.

76. See *infra* § VII, A.

77. This represents a departure from prior law which authorized a higher rate in used car financing. WIS. STAT. § 218.01(6) (1979).

78. WIS. STAT. § 421.301(13) (1979). This basically would entail a purchase for other than personal, family, household or agricultural purposes.

79. § 218.01(6)(bn)(2).

tations regardless of the purpose for which the mobile home is purchased.⁸⁰ Lastly, none of the restrictions or requirements of section 218.01(6) apply to any retail installment sale of a motor vehicle which is to be used primarily for business or commercial purposes.⁸¹

Since mobile home transactions are no longer subject to a rate limitation,⁸² section 218.11(6)(1) has been repealed.⁸³ It provided that a mobile home dealer's license could be revoked for assessing a finance charge in excess of the rate permitted by the Wisconsin Consumer Act.

VII. WISCONSIN CONSUMER ACT

A. *Finance Charge Rate On Closed-End Credit, Section 422.201(2)(bm)*

Section 422.201(2)(bm) establishes the maximum rate of finance charge for closed-end consumer credit other than credit extended by licensed loan companies. It applies to transactions entered into on or after November 1, 1981. The basic rate is 18% per year. Formerly, the rate was 18% per year on the first \$1,000 of the amount financed and 15% per year on that portion of the amount financed which exceeded \$1,000.⁸⁴ Alternatively, the credit grantor may now charge at a rate of six percentage points in excess of a rate determined by market activity in six month United States treasury bills. The applicable treasury bill rate for any month is the interest rate

80. § 218.01(6)(bn)(3).

81. § 218.01(6)(k). WIS. STAT. § 218.01(6)(b) (1979) requires that the seller shall deliver to the buyer a written statement describing clearly the motor vehicle sold to the buyer, the cash sale price, the cash paid down by the buyer, the amount credited the buyer for any trade-in and a description of trade-in, the cost to the retail buyer of any insurance, the amount financed which may include the cost of insurance, sales and use taxes, the amount of the finance charge, the amount of any other charge specifying its purpose, the total of payments due from the buyer, the terms of the payment of such total, the amount and date of each payment necessary finally to pay the total and a summary of any insurance coverage to be effected.

This section also establishes a series of rate ceilings, the permissible manner of computing finance charges, a provision for minimum finance charges, a prohibition against blank spaces in the contract, a provision as to the seller's liability to assignees for violations under this section, and a requirement of notice of assignment.

82. See *infra* §§ VII, E & F.

83. 1981 Wis. Laws ch. 45, § 26.

84. WIS. STAT. § 422.201(2)(a) (1979).

determined by the last auction of the bills in the preceding month, increased to the next multiple of 0.5% if the auction rate includes a fractional amount.⁸⁵

B. Finance Charge Rate On Sales of Farm Equipment, Farm Implements and Farm Tractors, Section 422.201(4)(b)

Under section 422.201(4)(b), the maximum rate which may be charged in a retail installment sale of farm equipment, farm implements or farm tractors where the amount financed is \$25,000 or less is the same rate as that applicable to closed-end consumer credit generally. This is a change from the prior law under which the maximum rate was the class two motor vehicle rate. There is no limitation on the rate of finance charge which may be assessed in other extensions of credit for an agricultural purpose.⁸⁶

C. Finance Charge Rate on Open-End Credit, Section 422.201(10m)

Under section 422.201(10m)(a) the basic rate for open-end credit plans is 18% per year on the balance subject to the finance charge. This is an increase over the former rate of 18% on the first \$1,000 of the balance subject to the finance charge and 15% per year on any portion of the balance over \$1,000.⁸⁷

Credit grantors who have open-end credit plans in existence on November 1, 1981, may increase the rate on those plans with respect to new transactions by giving their customers an appropriate notice.⁸⁸ A new purchase, cash advance or other debit transaction posted to an account established prior to November 1, 1981, is subject to the 18% rate if the creditor mails or delivers to the customer a written notice that the higher rate will be applied.⁸⁹ That notice must be mailed at least fifteen days prior to the beginning date of the billing cycle in which the transaction occurs. The higher rate may be applied to purchases, cash advances or other transactions

85. This would apply to auction rates not evenly divisible by 0.5%. Compare § 138.052(2)(b)(1) relative to fractional rates.

86. § 422.201(12).

87. WIS. STAT. § 422.201(10) (1979).

88. § 422.201(10m)(b).

89. § 422.201(10m)(h).

made on or after the beginning of that billing cycle. The action of the consumer in making the transaction constitutes acceptance of the higher rate as to that transaction if proper notice procedures are followed. A creditor electing this option must be able to calculate interest on transactions made prior to the date on which the finance charge is increased at the old rate and on new transactions at the increased rate. The creditor must also be able to properly disclose the applicable periodic rates on the billing statement for both components of the balance subject to the finance charge until the old balance is completely repaid.⁹⁰

If the creditor wishes to increase the rate of finance charge on the entire outstanding balance, including that portion of it evidencing transactions made prior to November 1, 1981, the credit grantor may do so. However, the creditor must follow the procedures in section 422.415,⁹¹ to accomplish this change. Under that section, the creditor must either provide the customer with one year's notice of the proposed rate increase or obtain the customer's agreement to the rate increase in writing.

Under certain circumstances, the creditor may exceed the 18% per year rate limit.⁹² The customer and creditor may agree that if the yield⁹³ on the two-year United States treasury notes exceeds 15% on each of the five successive Thursdays, the rate may be increased, subject to the notice requirements described in the next paragraph.⁹⁴ There is no limitation on the rate which the creditor may impose if the triggering event occurs. There are, however, limitations on the time period during which such a rate increase may remain in effect.⁹⁵ The higher rate may remain in effect for a 182 day period commencing on the first Friday after the fifth succes-

90. See 12 C.F.R. 226.7(b)(1)(v), (d) (1981). See also *Official Staff Commentary to Truth-in-Lending Regulation Z*, CONSUMER CREDIT GUIDE (CCH) No. 343 at 33 (Oct. 21, 1981).

91. Wis. STAT. § 422.415 (1979).

92. § 422.201(10m)(b).

93. 1981 Wis. Laws ch. 100, § 3 defined this yield as that obtaining on "the most recently auctioned 2-year U.S. treasury notes . . . as determined by the administrator [the Commissioner of Banking] based on the report of the federal reserve bank of New York." (to be codified at § 422.201(10m)(b)(1)).

94. § 422.201(10m)(b)(1).

95. § 422.201(10m)(b)(2).

sive Thursday on which the yield exceeds 15%. The creditor must then follow the yield for the last five Thursdays during this 182 day period. If the rate drops below 15% on any of those Thursdays, the maximum finance charge rate must drop to no more than 18% per year at the end of a ninety day period following the 182 day period. The creditor must again track the yield during this ninety day period. If it exceeds 15% on each of the last five successive Thursdays, a new 182 day period will commence on the Friday immediately following the fifth such Thursday. If it does not, the rate must return to no more than an 18% base rate at the end of the ninety day period.

The credit grantor may not, however, contract with the customer in a way which will automatically apply a rate of interest in excess of 18% per year. Each time the creditor wishes to impose such a rate, the creditor must mail the customer a notice of its intention to do so.⁹⁶ That notice must be mailed not more than sixty days and not less than thirty days prior to any change in the rate. The notice must contain the following information in this order:

1. A statement that the customer may pay the present outstanding balance under the preexisting terms, i.e., at the lower rate.
2. If the customer enters into additional open-end credit transactions after the expiration of the notice period, the higher rate will apply to the balance evidencing those transactions. The old rate will apply to preexisting balances.
3. The customer may agree to the application of the increased rate of charge to both existing and future balances. In order to do so, the customer must sign an *appropriate* agreement between the parties.⁹⁷
4. Upon the expiration of all consecutive periods in which the higher rate of finance charge may be imposed, the basic finance charge rate agreed to between the parties prior to the increased rate will apply to the entire unpaid balance,

96. § 422.201(10m)(b)(3).

97. A sales transaction slip used in a request for credit under the plan is not intended to be an *appropriate* agreement for the purposes of accepting a higher rate on a pre-notice balance. WISCONSIN LEGISLATIVE COUNCIL SPECIAL COMM. ON INTEREST RATE PRACTICES, REPORT OF THE OPEN-END CREDIT SUBCOMM. (March 6, 1981).

regardless of when the transactions evidencing that balance may have occurred.

Therefore, once the rate ceiling drops back to 18%, the entire balance subject to the finance charge will be subject to that rate or to such lower rate as the parties may have agreed. As a result, it is unlikely that at any particular time the creditor will ever be tracking balances subject to more than two rates. Assuming an originally agreed upon rate of 18%, tracking more than two rates will only occur during those periods during which a rate in excess of 18% may be imposed. Once the rate ceiling drops back to 18%, the agreed upon rate(s) will apply to the entire balance regardless of the timing of the transactions which make up that balance.

Sections 422.201(10m)(c) through (g) establish rules for calculating the finance charge in open-end credit plans. However, those rules are exactly the same as those described in sections 422.201(10)(a) through (d) contained in the Wisconsin Consumer Act originally, and reflect no substantive change in the Act.

D. Agricultural Credit, Section 422.201(12)

Agricultural credit, other than that involving the sale of farm implements, farm equipment and farm tractors, was removed from the rate limitations of the Wisconsin Consumer Act by chapter 168 of the Laws of 1979. That exemption is continued by this amendment contained in section 422.201(12). While the remainder of the Wisconsin Consumer Act applies to extensions of agricultural credit where the amount financed is \$425,000 or less, there is no rate limitation applicable to those transactions other than those covered by section 422.201(4).

E. Mobile Home Transactions, Section 422.201(12m)

Section 422.201(12m) exempts consumer credit sales or consumer loans secured by a first lien or equivalent security interest in a mobile home from the rate limitations of the Wisconsin Consumer Act. A mobile home is defined in section 218.10(2).⁹⁸ This exemption applies only to sales or loans made on or after November 1, 1981.

98. WIS. STAT. § 218.10(2) (1979).

*F. Additional Charges, Mobile Home Transactions,
Section 422.202(2)*

Section 422.202(2) was amended by chapter 45 to provide that the additional charges described in this section may be assessed in a mobile home transaction as defined in section 138.056(1)(c), and may be excluded from the finance charge.⁹⁹ Previously, this section applied to any consumer credit transaction secured by an interest in real property. The charges described in this section are, therefore, the types of charges normally associated with first or inferior lien real estate mortgage transactions. They include such things as fees for title examination or title insurance premiums, fees for the preparation of deeds or other documents, notarization fees, appraisal fees and survey costs. Since such charges are excludable from the finance charge only if paid to *unrelated* third parties,¹⁰⁰ it is difficult to imagine that a title examination, title insurance, or surveys will ever be involved in connection with a mobile home transaction which does not also involve a security interest in real estate. For the same reason, it is also unlikely that credit grantors will begin having mobile homes appraised if that is not part of the custom and usage of the trade at the present time. It will, of course, be interesting to note whether mobile home dealers and lenders begin charging fees for document preparation and notarization in connection with mobile home transactions which do not involve real estate.

*G. Additional Charges, Open-End Credit, Section
422.202 (2m)*

Section 422.202(2m) permits a creditor to assess certain additional charges in connection with an open-end credit plan. Creditors may amend existing open-end credit plans to incorporate these charges as well as include them in new accounts opened with customers following the effective date of this act. With one exception, they are not included in the finance charge for purposes of determining the maximum rate under section 422.201(10m).

99. Mobile home transactions are not subject to rate limitations. § 422.201(12m). Thus, these fees would not create a usury problem for a merchant even if included in the finance charge.

100. § 422.202(2). Compare § 138.052(3)(a) (word "unrelated" omitted).

1. Late Payment Charge

A creditor may contract to assess the customer a charge not to exceed \$2.00 in any billing cycle in which the customer pays less than the minimum payment due.¹⁰¹ The minimum payment is one of the terms of the open-end credit plan. However, the creditor may not include this charge as part of the minimum payment. For example, if the customer has a balance of \$100.00 as a result of purchases and cash advances, the minimum payment might be \$10.00¹⁰² and the finance charge \$1.50.¹⁰³ Suppose the customer did not make a minimum payment during that billing cycle. If the late payment provision were part of the contract, the customer could be assessed a delinquency charge of \$2.00. However, the creditor could not calculate a finance charge on \$103.50¹⁰⁴ during the following billing cycle. The finance charge would be calculated on \$100.00 or, if the credit grantor compounds the interest charge, on \$101.50.¹⁰⁵ Similarly, the minimum payment during the next billing cycle would be \$10.00 rather than \$12.00, i.e., the \$2.00 late charge may not be added into the minimum payment due. However, if the customer pays at least \$10.00 during the succeeding billing cycle, the credit grantor may allocate \$2.00 to the outstanding late payment charge. Consequently, if the customer fails to pay the late payment charge as soon as it is assessed, in addition to the minimum payment due, the net result may be a slower reduction in the principal balance and thus a greater total finance charge.

2. Minimum Finance Charge

If the billing cycle contains at least twenty-eight calendar days and the customer's balance subject to the finance charge is less than \$33.34,¹⁰⁶ a creditor may impose a minimum

101. § 422.202(2m)(a).

102. A typical open-end credit agreement in Wisconsin requires a minimum monthly payment of the greater of 4% of the outstanding balance subject to the finance charge or \$10.00.

103. This assumes an annual percentage rate of 18%.

104. This is the \$100.00 principal balance plus a \$1.50 finance charge plus a \$2.00 delinquency charge.

105. This is the \$100.00 principal balance plus a \$1.50 finance charge.

106. An annual percentage rate of 18% applied to \$33.34 for one month yields a finance charge of \$0.50.

finance charge of \$0.50 for that billing cycle.¹⁰⁷ However, in any billing cycle in which a creditor elects to impose this charge, the creditor may not impose the \$2.00 late payment charge even if the customer has not paid the minimum payment due during that billing cycle. The creditor must elect between these two charges. The imposition of this charge on an existing credit plan would ordinarily be an adverse change and, therefore, subject to the one year notice requirement in section 422.415. However, that notice requirement is expressly waived by section 422.202(2m)(b) which enables creditors to modify existing open-end credit plans to incorporate this charge.

3. Cash Advance Fee

A creditor may charge an amount not to exceed \$2.00 for each cash advance other than one authorized by the use of a seller credit card or an overdraft checking plan.¹⁰⁸ A seller credit card is defined in section 421.301(41),¹⁰⁹ as one in which the creditor provides the customer with a credit card or other credit confirmation or identification primarily for the purpose of purchasing or leasing goods or services either from the creditor, a person related to the creditor or other persons licensed or franchised to do business under the creditor's business or trade name. An overdraft checking loan is defined in section 422.202(2m)(c)(2), and includes any loan made when the customer overdraws a debit account maintained with a supervised financial organization. Because of these exceptions, a retail credit grantor could not, for example, permit customers to receive cash advances through the use of its seller credit card and charge the customer up to \$2.00 for each such cash advance. Moreover, if a financial institution has an open-end credit plan which enables the customer to overdraw a checking account or NOW account, the creditor may not impose a cash advance charge when the customer obtains cash through the exercise of this overdraft privilege. The charge may only be imposed when the customer uses a card issued by a lender to obtain cash in a transaction which is actually a loan and

107. § 422.202(2m)(b).

108. § 422.202(2m)(c).

109. WIS. STAT. § 421.301(41) (1979).

which is not tied to any debit account maintained with the card issuer.

4. Fees Approved by the Administrator.

Section 422.202(2m)(e) also permits creditors to continue to assess additional charges which the administrator of the Wisconsin Consumer Act has, prior to the effective date of this Act, determined to be excludable from the finance charge. The Wisconsin Consumer Act is administered by the Commissioner of Banking.¹¹⁰ The Commissioner, by interpretation, has authorized credit grantors to assess a customer a fee to obtain a credit card¹¹¹ and fees for replacement of lost cards and to exclude those fees from the finance charge under section 422.201.¹¹² However, this section on additional charges provides that any future additional charges approved by the administrator must be implemented by rulemaking rather than by interpretation.

H. Delinquency Charges, Section 422.203

Section 422.203(1) was modified to authorize larger delinquency charges in mobile home transactions as defined in section 138.056(1)(c). In such transactions, the creditor may assess a delinquency charge not to exceed six dollars or 3% of the unpaid amount of the installment, whichever is less.¹¹³ In other consumer credit transactions, the delinquency charge is limited to three dollars or 3% of the unpaid amount of the installment, whichever is less.

Interest after maturity may not exceed either 12% or the annual percentage rate assessed on the transaction, whichever is greater.¹¹⁴ Thus, interest rate limitations after maturity on consumer credit transactions are continued in the same manner under chapter 45 as under chapter 168 of the Laws of

110. *Id.* § 426.103.

111. Letter from the Office of the Comm'r of Banking to Marine Nat'l Exch. Bank (Apr. 7, 1980).

112. Letter from the Office of the Comm'r of Banking to First Wisconsin Corp. (Dec. 17, 1980).

113. Note that the limitations on delinquency charges found in the Wisconsin Consumer Act, § 422.203, apply and not the limitations found in the section on mortgages, § 138.052(6).

114. § 422.203(4).

1979. However, if that interest is charged, no delinquency charge may be taken on the final scheduled installment.¹¹⁵ This modification to the Wisconsin Consumer Act is intended to prevent the situation in which interest after maturity would be at a rate which is lower than the rate in effect during the anticipated amortization of the debt. Were it otherwise, it might be to the customer's advantage to default and pay the lower rate of interest associated with an accelerated balance.

I. Rebate Upon Prepayment, Section 422.209

Section 422.209 was modified to restrict the use of the Rule of 78 to short-term consumer credit transactions. The Rule of 78 is a formula used to determine the amount of unearned interest at the time a consumer credit transaction is prepaid in full. The customer's outstanding balance is reduced by the amount of the unearned interest to assure that the total finance charge is approximately equivalent to the application of the annual percentage rate to the outstanding principal balances for the periods it is anticipated each would be outstanding. However, as the annual percentage rate and the term of the transaction increase, the amount of interest earned through application of the Rule of 78 becomes increasingly greater than that which would be earned through application of the actuarial method.¹¹⁶

Consequently, section 422.209(2)(a) has been modified to permit the use of the Rule of 78 only in transactions having initial terms of less than forty-nine months. In consumer credit transactions which have terms of forty-nine months or more, the lender may use one of two alternative formulas in calculating the unearned portion of the finance charge.¹¹⁷

On the one hand, the creditor may calculate the dollar amount of the finance charge allocable to all unexpired payment periods as of the date of prepayment. A payment period is considered to be unexpired if prepayment occurs within fifteen days following the payment's due date. The unearned finance charge is the finance charge which would be earned for each unexpired payment period by applying to the unpaid

115. § 422.203(4)(c).

116. "Actuarial method" is defined in Wis. ADMIN. CODE § BKG. 80.221 (1981).

117. § 422.209(2)(b).

balance of principal during each payment period the annual percentage rate disclosed to the customer. This calculation may be made assuming all payments occur as scheduled or as deferred. The calculation is to be made according to the actuarial method. That method is described as the method by which the portion of any payment not applicable to an escrow account is applied first to any finance charge or permitted additional charge accrued from the time of any prior payment and the remainder, if any, is applied to the unpaid amount financed. The creditor may decrease the annual percentage rate to the next multiple of 0.25% when calculating the unearned finance charge under this method.¹¹⁸

Alternatively, the creditor may calculate the unearned finance charge by deducting from the total finance charge the amount determined by applying the annual percentage rate, according to the actuarial method, to the unpaid balances for the actual time those balances were unpaid up to the date of prepayment.

If the loan has been deferred, the unearned portion of the deferral charge may be determined by multiplying the total deferral charge by the number of unexpired payment periods as of the date of prepayment and dividing the result by the total number of installments deferred.¹¹⁹ In other words, deferral charges are earned on a *pro rata* basis. If, however, the unearned finance charge is calculated under subsection (2)(b), the deferral charge is refunded in full since the calculation of the finance charge under such subsection reflects an additional yield from a deferral.¹²⁰

If a mobile home transaction is prepaid in full, the credit grantor may exclude from the finance charge fees, discounts or other sums imposed by the Government National Mortgage Association, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation or any other secondary mortgage market purchaser of the loan who is not related to the original lender.¹²¹

118. Compare § 422.201(2)(bm) and text *supra* § VII, A relative to fractional rates.

119. § 422.209(4)(a).

120. § 422.209(4)(b).

121. § 422.209(6m).

The restriction on the use of the Rule of 78 applies to transactions entered into on or after the first day of the sixth month beginning after the effective date of this Act. Therefore, it will only apply to transactions consummated on or after May 1, 1982.¹²²

J. Balloon Payments, Section 422.402

The balloon payment provision has been amended to permit balloon payments in the following simple interest¹²³ consumer credit transactions.¹²⁴ In a consumer loan, a balloon payment is permissible if the annual percentage rate (APR) is not more than 18%. In a consumer credit sale, a balloon payment is permissible if the seller retains a security interest in real estate which is the subject of the sale and the APR is not more than 18%. Formerly, balloon payments were permitted in these transactions only if the APR was less than 16.5%. Balloon payments continue to be permitted in transactions pursuant to open-end credit plans as well as transactions primarily for agricultural purposes. However, balloon payments are no longer permitted in consumer sales not secured by real estate where the APR is less than 12%. The only non-agricultural sales covered by the current balloon payment exemption are those secured by real estate.

There is, however, a slight modification for mobile home transactions.¹²⁵ These transactions may contain a balloon payment if the transaction complies with section 138.056, or the the unequal or irregular payment is the final payment and the merchant agrees to refinance the final payment at a rate of interest which does not exceed the APR by more than 1% multiplied by the number of six month periods contained in the original transaction.¹²⁶

K. Open-End Credit, Notice of Termination of Liability, Section 422.4155

Section 422.4155 was created to provide a mechanism under which a person who is a customer under an open-end

122. The effective date of the Act is Nov. 1, 1981. 1981 Wis. Laws ch. 45, § 53.

123. That is, non-precomputed transactions. Wis. STAT. § 421.301(35) (1979).

124. § 422.402(1), (1m).

125. § 422.402(5).

126. An example is offered by way of explanation. Assume a two year note at 15.5%. Two years divided by six months equals four. Thus, the maximum rate upon refinancing would be 19.5%. [$15.5\% + 4(1\%)$].

credit plan may terminate his or her liability for future extensions of credit under the plan. This section applies to open-end credit plans where there are multiple customers and at least one of them wishes to terminate future liability with respect to extensions of credit to others. The terminating party must give written notice of his or her intention to do so to the creditor. That customer's liability continues with respect to loans or purchases made by any other customer for fifteen business days after the creditor's receipt of the termination notice. However, the terminating customer's liability may not exceed the customer's credit limit¹²⁷ under the plan, or the balance outstanding under the plan on receipt of the termination notice plus \$500, whichever is greater.

Since the terminating customer's liability is dependent upon the timing of the receipt of the termination notice by the creditor, the customer would be advised to either send this notice by registered mail or some other method which would provide documentary evidence of receipt of the notice by the creditor. This provision protects the terminating customer from contractual provisions in the open-end credit plan which would ordinarily obligate the terminating customer for all amounts purchased under the plan, including purchases which exceed the credit limits of the parties to the account. This provision is intended to override any claimed liability of the terminating party based on the doctrine of necessities.¹²⁸ It also preempts contractual provisions which would appear to preclude termination unless the terminating customer is able to surrender all cards issued on that account. The terminating customer remains liable, of course, for any extensions of credit which are made to that customer after he or she has given the termination notice.

L. Application of Chapter 428, Section 428.101(3)

Section 428.101(3) was created to apply chapter 428 to all first lien or equivalent real estate mortgage loans made by any

127. The credit limit must have been "requested and contracted for" by the customer. § 422.4155(1). Unilateral increases of such limit by the creditor would not satisfy this requirement.

128. WISCONSIN LEGISLATIVE COUNCIL SPECIAL COMM. ON INTEREST RATES, REPORT OF THE OPEN-END CREDIT SUBCOMM. (May 14, 1981) (adopted by Committee by 12-2 vote).

financial institution if the amount financed is \$25,000 or less. Loans which are covered by chapter 428 are exempt from coverage under the Wisconsin Consumer Act. Formerly, first lien real estate mortgage loans made by savings and loan associations for amounts of \$25,000 or less were covered by chapter 428 (and thereby exempt from the Wisconsin Consumer Act) only if the APR was 12% or less.¹²⁹

*M. Rejection of Federal Preemption, Section 50,
Chapter 45*

Section 50 of chapter 45 expressly rejects the federal preemptions of state usury statutes contained in sections 501(a)(1), 511, 521, 522 and 523 of Public Law 96-221 as amended by Public Law 96-399.¹³⁰ These references are to the Depository Institutions Deregulation and Monetary Control Act (DIDMCA) which exempted real estate mortgage loans, business and agricultural loans, and certain consumer loans from the rate limitations of state law. The DIDMCA provided that a state could, within specified time frames, override or reject these federal preemptions. Wisconsin has done so in chapter 45. However, under state law, at the present time, there are no rate limitations on commercial, first lien real estate mortgages, and most agricultural credit.¹³¹

VIII. PARITY PROVISIONS

A. Federal Rate Parity, Section 138.041(2)

Section 138.041(2) continues federal rate parity originally established in chapter 168 of the Laws of 1979. The subsection provides that if the federal government prescribes a maximum rate of interest for national banks, federally chartered credit unions or savings and loans, institutions in the parallel state industries may assess the same rate on loans or forebearances. The section provides, however, that a state-chartered financial institution may not assess a rate of inter-

129. Wis. STAT. § 428.101(2) (1979).

130. Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (codified as amended in scattered sections of 12 U.S.C.).

131. See *supra* note 66 and accompanying text; see *supra* § VII, B.

est permitted under federal law if that federal rate is based on a state statute which does not apply to state-chartered banks, credit unions or savings and loans, respectively. An example will most easily explain this last statutory limitation. National banks may, by virtue of 12 U.S.C. § 85,¹³² charge the highest rate allowed to lenders in a given state by the terms of the laws of that state. This is commonly referred to as the "most favored lender" doctrine, and means in Wisconsin that national banks may legally charge licensed loan company rates. 12 U.S.C. § 85 refers to a rate *created under state law* and accordingly, that aspect of the federal rate structure does not apply to state-chartered banks because of the limitation in section 138.041(2). Thus, state-chartered banks and savings and loans do not enjoy "most favored lender" status under chapter 45.¹³³

The only state-chartered institutions which have been affected by this section are credit unions. The National Credit Union Association, which regulates federally-chartered credit unions, has, under federal law, authorized federal credit unions to assess interest at rates up to 21% per year.¹³⁴ Wisconsin credit unions are granted rate parity as a result of this action by the NCUA, by virtue of section 138.041(2).

B. Federal Powers of Banks, Savings and Loans, and Credit Unions, Sections 220.04(8), 215.02(18), & 186.012(4)

Sections 220.04(8), 215.02(18) and 186.012(4) provide that the respective commissioners may by rule authorize their respective industries to exercise any power under the notice, disclosure or procedural requirements governing federally-chartered financial institutions or make any loan or investment or exercise any right, power or privilege of a federally-chartered financial institution under any federal law, regulation or interpretation.¹³⁵ The notice, disclosure and proce-

132. 12 U.S.C. § 85 (Supp. IV 1980).

133. For a discussion of most favored lender status as it applies to national banks, see *Northway Lanes v. Hackley Union Nat'l Bank & Trust Co.*, 464 F.2d 855 (6th Cir. 1972).

134. 12 C.F.R. § 701.21-A (1980) (as amended by 46 Fed. Reg. 34,796 (1981)) applies to transactions on or after Dec. 3, 1980 until June 3, 1982.

135. As this Article was being written, several federal rights, powers or privileges were being proposed by the Wisconsin Comm'r of Savings and Loans for state chartered savings and loan associations. Clearinghouse Rule 81-221.

dures that may be modified by a rule adopted by the commissioner include, but are not limited to, those provided for variable rate real estate mortgage loans.

The commissioners' authority under these sections are limited in several ways. First, the proposed rule must be approved by the Banking Review Board,¹³⁶ the Credit Union Review Board,¹³⁷ or the Savings and Loan Review Board,¹³⁸ as appropriate. Secondly, the commissioners are restricted from acting under these subsections if the commissioners' authority to act with respect to a particular power, right or privilege is expressly restricted by statute. Finally, no rules adopted under these sections may affect section 138.041 or chapters 421 to 428. Consequently, no commissioner may adopt a rule which conflicts with the Wisconsin Consumer Act, including any rule adopted by the commissioner administering the Act. No rule may restrict powers otherwise granted to financial institutions under the statutes which create them. That language seems superfluous since it is inconceivable that a commissioner would adopt a rule based on federal authority which would impair the ability of a financial institution to act under its state powers. In addition, the commissioners' rule making authority is, of course, subject to legislative oversight under chapter 227, although amendments to section 227.027 enable the commissioners to adopt emergency rules which are of greater duration than those ordinarily permitted.

Normally, emergency rules remain in effect for 120 days. However, emergency rules adopted under these three sections remain in effect for one year or until the emergency rule is suspended. If, prior to the expiration of the emergency rule, the agency issues a proposed permanent rule, the Joint Committee for Review of Administrative Rules may suspend that proposed rule. If that occurs prior to one year from the effective date of the emergency rule, the emergency rule is suspended as well. If the emergency rule is suspended or a proposed rule is disapproved by the Joint Committee, the statute provides for a wind-down period. Any person may complete a

136. § 220.04(8).

137. § 186.012(4).

138. § 215.02(18).

transaction entered into or committed to in reliance on the rule and shall have forty-five days to discontinue other activity undertaken in reliance on the rule.

IX. SUNSET PROVISION

Chapter 45 provides for rate deregulation as of November 1, 1984. At that time, many of these provisions will become inoperative and Wisconsin will enter a period of general deregulation with respect to ceiling rates of interest on credit transactions. However, that deregulation period is, itself, subject to a sunset provision. On November 1, 1987, the deregulation period will terminate and in the absence of any legislative action, Wisconsin will revert to the law described herein.

The following statutory provisions affected by chapter 45 will remain in effect during the rate deregulation period between October 31, 1984 and November 1, 1987: 138.052, 138.056, 138.09(3)(e), 138.12(11), 186.012, 215.02, 220.04(8), 227.027(1), 422.201 (12m), 422.202(2), 422.202(2m), 422.203(1), 422.209(2)(b), 422.209(6m) and 422.4155.

X. CONCLUSION

Chapters 45 and 100 of the Laws of 1981 represent the most comprehensive recodification and restructuring of Wisconsin's usury laws ever enacted. The legislature has attempted to revise the law to reflect a dramatically evolved residential real estate market. It has authorized flexibility in mortgage financing to an unprecedented degree, in large part in response to changing national priorities in housing policies. Similarly, the law now recognizes additional flexibility in rate ceilings for non-mortgage consumer credit transactions. This decreased rigidity in legal restrictions reflects the relatively greater uncertainties which borrowers face in today's more turbulent credit markets. The law does, however, retain the notions of the importance of consumer protections and of the desirability of rate ceilings for non-mortgage consumer credit, albeit on a relatively less restrictive basis. Further, the state has made a definitive statement of its interest in this subject matter by explicitly and emphatically rejecting any federal preemption in this area.

The period from November 1, 1984 through October 31, 1987, during which rate ceilings will be removed, is intended

to provide an experimental era in which credit markets can operate in the absence of rate ceilings. The political volubility of this concept, the numerous technical and definitional problems in the law, and the internal inconsistencies still extant in the law all combine to assure that future legislatures will again be addressing this subject matter.